

Institutional Equity Research

Cyient

IT | India

1QFY18 Result Update | July 13, 2017

CMP* (Rs)	516
Upside/ (Downside) (%)	10
Bloomberg Ticker	CYL IN
Market Cap. (Rs bn)	58
Free Float (%)	78
Shares O/S (mn)	113

BUY 

Target Price: Rs565

Core Business Enthuses, But DLM Biz Plays Spoilsport

Cyient's USD revenue declined by 0.3% QoQ to US\$140.6mn in 1QFY18 vs. our estimate of 2.9% QoQ growth. However, core business showed a decent 3% QoQ growth, which comes on top of a 3.3% QoQ growth in 4QFY17. The core ENGG business grew by a solid 4% QoQ in USD terms, which comes on top of a 3.5% QoQ growth in 4QFY17. On the other hand, the DNO business clocked 1.7% QoQ growth in USD revenue (3% QoQ growth in 4QFY17). However, the DLM segment (Rangsons) has reported a disappointing 26.2% QoQ decline in USD revenue. On the positive side, on a YoY basis, DLM revenue grew 17.2%.

Cyient has maintained its growth outlook for FY18. It expects double-digit growth in core services business, 20% growth in DLM business, 50bps expansion in EBITDA margin (mainly led by core services business) and double-digit earnings growth. This signifies that Cyient expects the DLM business to record healthy growth in coming quarters led by enhanced capacity and order backlog. Vertical-wise, the outlook remains strong, with positive trends in key segments including Aerospace, Communications, Medical and Utilities. The Semiconductor vertical has shown enthusing growth and the outlook appears to be stronger than the post-4QFY17 scenario, led by new engagements with existing clients and a better outlook for CY17.

Key Verticals Drive Growth

Cyient's revenue declined 0.3% QoQ to US\$140.6mn. Implied volume declined by 3.4% QoQ in light of lower utilisation, with growth coming mainly through a strong 6.6% QoQ improvement in pricing. In core services, Aerospace & Defense (+1.6% QoQ), Transportation (+11.5%), Semiconductor (+10.4%), Medical & Healthcare (+8.5%) and Communications (+9.8%) were the key verticals that drove growth. Though Utilities & Geospatial saw a 7.5% QoQ decline in revenue owing to de-growth in business from some key clients, management believes that the vertical will clock double-digit growth led by strong deal pipeline. From margin perspective, EBITDA margin decline was restricted to 46bps QoQ, which is decent given major headwinds like lower utilisation, wage hikes and INR appreciation.

Outlook & Valuation

At CMP, the stock trades at a PE of 12x FY19E EPS, which we believe to be reasonable given improving metrics in core business, margin expansion, strong traction in most verticals, strong client relationships, decent dividend yield, quality balance sheet and healthy EPS growth (19% CAGR) over FY17-FY19E. We are enthused by the strong traction Cyient is witnessing in its business and believe that it should command a higher multiple in light of better growth. **We retain our BUY recommendation on Cyient with an unchanged Target Price of Rs565.**

Key Financials (Rs mn)	FY15	FY16	FY17	FY18E	FY19E
Net Revenue	27,359	31,021	36,065	39,108	44,470
EBITDA	4,008	4,141	4,772	5,561	6,688
APAT	3,532	3,255	3,438	3,982	4,839
Diluted EPS (Rs)	31.4	28.9	30.5	35.4	43.0
P/E (x)	16.4	17.8	16.9	14.6	12.0
EV / EBITDA (x)	13.2	12.7	10.5	8.7	6.8
RoE (%)	20.6	17.3	17.1	17.8	19.5

Source: Company, RSec Research

Share price (%)	1 mth	3 mth	12 mth
Absolute performance	(1.4)	7.3	1.2
Relative to Nifty	(4.3)	(0.7)	(17.5)

Shareholding Pattern (%)	Dec'16	Mar'17
Promoter	22.2	22.2
Public	77.8	77.8

1 Year Stock Price Performance



Note: * CMP as on July 13, 2017

Research Analyst: Harit Shah
 Contact: 022 33201276
 Email: harit.shah@relianceada.com

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Key Conference Call Takeaways

- ▶ The revenue decline in DLM business is attributable to seasonality, which was in-line with the management's expectations.
- ▶ Cyient has outstanding hedges of US\$118m, and will earn ~US\$7.2mn profit on forward contracts at current exchange rates.
- ▶ Cyient has maintained its target of 50bps EBITDA margin expansion in FY18, led mainly by the core services business, which expanded by 60bps in FY17.
- ▶ Utilisation, higher off-shoring, pricing, operational efficiency and employee pyramid are seen as the key margin levers for FY18.
- ▶ Cyient awarded wage hikes in 1QFY18, which had ~90-100bps impact on margins, and there will be a similar impact in 2QFY18E as well.
- ▶ The DLM business is likely to become cash-positive in 1HFY18 and is likely to attain operating break-even for the full year.
- ▶ Cyient saw a rise in tax rate owing to slower-than-expected ramp-up in its SEZs, as more work has been witnessed onsite.
- ▶ Softential recorded ~US\$3-3.5mn revenue with 10% margin.

Key Risks

- ▶ Any client-specific issues emanating from the Top-10 clients could drag revenue.
- ▶ Growth issues in its largest vertical i.e. Aerospace.
- ▶ Generic growth volatility associated with a mid-sized IT firm.
- ▶ Event-specific risks i.e. BREXIT could impact IT budgets, cut discretionary spends and delay new deals.
- ▶ With Donald Trump as the US President, the risk of noise regards offshoring taking away US jobs, higher visa cost and a more punishing visa regime abound.
- ▶ Currency risks.

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Exhibit 1: Quarterly Performance (Consolidated, Rs mn)

Particulars (Rs mn)	1QFY18	4QFY17	QoQ (%)	1QFY17	YoY (%)
Net Revenues (US\$ mn)	140.6	141.0	(0.3)	124.7	12.8
Net Revenues	9,070	9,410	(3.6)	8,349	8.6
Cost of Revenue	5,904	6,179	(4.5)	5,424	8.8
Gross Profit	3,166	3,231	(2.0)	2,925	8.2
SG&A Expenses	2,006	1,984	1.1	1,835	9.3
EBITDA	1,160	1,247	(7.0)	1,090	6.4
Depreciation	261	255	2.4	223	17.0
EBIT	899	992	(9.4)	867	3.7
Interest Cost	52	38	36.8	53	(1.9)
Other Income	351	265	32.5	116	203.4
PBT	1,198	1,219	(1.7)	930	28.9
Tax	373	221	68.8	237	57.4
Min. Int. And Ass. Profit Share	53	47	12.3	47	12.1
APAT	878	1,045	(16.0)	740	18.6
E/o (adj for tax)	0	(261)	-	0	-
RPAT	878	784	12.0	740	18.6

Source: Company, RSec Research

Exhibit 2: Margin Break Up

Particulars	1QFY18	4QFY17	QoQ (bps)	1QFY17	YoY (bps)
Cost of Revenue % Net Revenues	65.1	65.7	(57)	65.0	13
SG&A Expenses % Net Revenues	22.1	21.1	103	22.0	14
Gross Profit Margin (%)	34.9	34.3	57	35.0	(13)
EBITDA Margin (%)	12.8	13.3	(46)	13.1	(27)
EBIT Margin (%)	9.9	10.5	(63)	10.4	(47)
Tax Rate (%)	31.1	18.1	1,301	25.5	564
APAT Margin (%)	9.7	11.1	(143)	8.9	82

Source: Company, RSec Research

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Exhibit 3: Key Assumptions

Particulars	FY15	FY16	FY17	FY18E	FY19E
DNO USD revenue growth (%)	32.0	(6.6)	22.8	14.6	14.5
ENGG USD revenue growth (%)	14.2	2.2	5.5	9.7	12.5
DLM USD revenue growth (%)	-	332.2	36.9	15.2	15.1
Total USD revenue growth (%)	23.0	5.7	13.9	12.0	13.5
USD/INR rate	61.22	65.69	67.04	64.89	65.00
EBITDA margin (%)	14.7	13.3	13.2	14.2	15.0

Source: Company, RSec Research

Exhibit 4: Segmental contribution

(% of revenue)	3QFY16	4QFY16	1QFY17	2QFY17	3QFY17	4QFY17	1QFY18
DNO	33.6	32.4	33.5	36.3	37.2	36.9	37.7
ENGG	57.2	57.2	58.4	53.8	51.9	51.7	53.9
Rangsons	9.2	10.4	8.1	9.9	10.9	11.4	8.4
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Company, RSec Research

Exhibit 5: Segmental growth

(QoQ, %)	3QFY16	4QFY16	1QFY17	2QFY17	3QFY17	4QFY17	1QFY18
DNO	1.2	(1.8)	6.7	18.6	2.0	3.0	1.8
ENGG	(1.4)	1.9	5.4	0.9	(4.1)	3.5	4.0
Rangsons	6.8	16.0	(20.1)	33.5	10.2	8.0	(26.2)
Total	0.2	1.9	3.1	9.5	(0.5)	3.8	(0.3)

Source: Company, RSec Research

Exhibit 6: Onsite-offshore contribution (Ex-Rangsons)

(% of revenue)	3QFY16	4QFY16	1QFY17	2QFY17	3QFY17	4QFY17	1QFY18
Onsite	56.7	59.0	59.3	59.9	59.6	60.8	59.6
Offshore	43.3	41.0	40.7	40.1	40.4	39.2	40.4
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Company, RSec Research

Exhibit 7: Onsite-offshore growth (Ex-Rangsons)

(QoQ, %)	3QFY16	4QFY16	1QFY17	2QFY17	3QFY17	4QFY17	1QFY18
Onsite	1.8	4.7	6.3	8.4	(2.2)	5.4	1.0
Offshore	(3.2)	(4.9)	5.1	5.8	(0.9)	0.2	6.2
Total	(0.5)	0.5	5.9	7.4	(1.7)	3.3	3.0

Source: Company, RSec Research

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Exhibit 8: Vertical contribution (Ex-Rangsons)

(% of revenue)	3QFY16	4QFY16	1QFY17	2QFY17	3QFY17	4QFY17	1QFY18
Aerospace & Defense	37.7	38.9	38.7	36.8	35.6	35.7	35.2
Transportation	10.2	10.0	10.3	9.4	9.4	9.7	10.5
Industrial, Energy & Natural Resources	10.8	10.3	10.0	9.3	9.3	8.7	8.5
Semiconductor	4.3	4.4	4.3	4.1	3.9	4.2	4.5
Medical & Healthcare	1.5	1.7	1.9	1.9	1.9	1.9	2.0
Utilities and Geospatial	15.7	16.8	15.8	16.7	17.2	18.5	16.6
Communications	19.4	17.6	18.9	21.8	22.7	21.3	22.7
Others	0.4	0.3	0.1	0.0	0.0	0.0	0.0
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Company, RSec Research

Exhibit 9: Vertical growth (Ex-Rangsons)

(QoQ, %)	3QFY16	4QFY16	1QFY17	2QFY17	3QFY17	4QFY17	1QFY18
Aerospace & Defense	3.7	3.7	5.3	2.1	(4.9)	3.6	1.6
Transportation	(4.2)	(1.5)	9.0	(2.0)	(1.7)	6.6	11.5
Industrial, Energy & Natural Resources	(5.7)	(4.1)	2.8	(0.2)	(1.7)	(3.4)	0.7
Semiconductor	(19.2)	2.9	3.4	2.4	(6.5)	11.3	10.4
Medical & Healthcare	(0.5)	13.9	18.3	7.4	(1.7)	3.3	8.5
Utilities and Geospatial	(1.1)	7.6	(0.4)	13.5	1.3	11.1	(7.5)
Communications	5.0	(8.8)	13.7	23.8	2.4	(3.1)	9.8
Others	(50.2)	(24.6)	(64.7)	(100.0)	N.A.	N.A.	N.A.
Total	(0.5)	0.5	5.9	7.4	(1.7)	3.3	3.0

Source: Company, RSec Research

Exhibit 10: Geographical contribution (Ex-Rangsons)

(% of revenue)	3QFY16	4QFY16	1QFY17	2QFY17	3QFY17	4QFY17	1QFY18
North America	63.6	60.2	60.0	59.1	58.0	57.1	55.8
Europe, ME, Africa and India	23.2	25.4	24.6	24.0	24.0	25.1	26.6
Asia Pacific	13.2	14.4	15.4	16.9	18.0	17.8	17.6
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Company, RSec Research

Exhibit 11: Geographical growth (Ex-Rangsons)

(QoQ, %)	3QFY16	4QFY16	1QFY17	2QFY17	3QFY17	4QFY17	1QFY18
North America	(1.2)	(4.9)	5.5	5.7	(3.5)	1.7	0.7
Europe, ME, Africa and India	(4.2)	10.1	2.5	4.7	(1.7)	8.0	9.2
Asia Pacific	11.4	9.7	13.2	17.8	4.7	2.2	1.9
Total	(0.5)	0.5	5.9	7.4	(1.7)	3.3	3.0

Source: Company, RSec Research

Exhibit 12: Headcount, utilisation data

(Nos.)	3QFY16	4QFY16	1QFY17	2QFY17	3QFY17	4QFY17	1QFY18
Total headcount	12,186	12,498	12,965	13,216	13,094	13,084	13,206
Technical employees	11,481	11,784	12,273	12,500	12,364	12,279	12,416
Support employees	705	714	692	716	730	805	790
Net additions	160	312	467	251	(122)	(10)	122
Gross utilisation (%)	76.7	73.1	77.6	82.5	82.9	82.5	78.8
Utilisation including support (%)	72.3	68.9	73.5	78.0	78.3	77.4	74.1

Source: Company, RSec Research

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Profit & Loss Statement

Y/E March (Rs mn)	FY15	FY16	FY17	FY18E	FY19E
Total Revenue (US\$ mn)	446.9	472.2	538.0	602.7	684.2
Growth (%)	23.0	5.7	13.9	12.0	13.5
Total Revenue	27,359	31,021	36,065	39,108	44,470
Growth (%)	24.0	13.4	16.3	8.4	13.7
Total Operating Expenses	23,351	26,880	31,293	33,547	37,782
EBITDA	4,008	4,141	4,772	5,561	6,688
EBITDA (%)	14.7	13.3	13.2	14.2	15.0
EBITDA Growth (%)	(2.3)	3.3	15.2	16.5	20.3
Depreciation	713	888	953	1,066	1,171
EBIT	3,295	3,253	3,819	4,495	5,517
EBIT (%)	12.0	10.5	10.6	11.5	12.4
EBIT Growth (%)	(2.6)	(1.3)	17.4	17.7	22.7
Other Income	1,218	1,085	932	971	1,122
Interest	58	164	172	165	157
PBT	4,456	4,174	4,579	5,301	6,482
Tax (incl deferred)	1,096	1,011	1,046	1,447	1,775
Minority Interest & associate profit	173	179	166	128	133
Extraordinary Items	0	(87)	(261)	0	0
PAT	3,532	3,255	3,438	3,982	4,839
PAT Growth (%)	32.8	(7.8)	5.6	15.8	21.5
EPS	31.4	28.9	30.5	35.4	43.0
EPS Growth (%)	32.8	(7.8)	5.6	15.8	21.5

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Balance Sheet

Y/E March (Rs mn)	FY15	FY16	FY17	FY18E	FY19E
SOURCES OF FUNDS					
Share Capital - Equity	562	562	563	563	563
Reserves	17,879	18,537	20,610	22,905	25,721
Total Shareholders' Funds	18,441	19,099	21,173	23,468	26,284
Total Debt	1,474	2,142	1,651	1,651	1,651
Long Term Provisions & Others	782	744	1,080	1,080	1,080
Deferred Tax Liability (Net)	51	42	302	302	302
Minority Interest	122	128	26	26	26
Creditors	2,754	3,107	4,021	4,400	5,162
Other Current Liab. & Provns	2,163	2,107	3,111	3,177	3,249
Total Current Liabilities	4,916	5,214	7,132	7,576	8,411
Total Sources Of Funds	25,786	27,370	31,364	34,104	37,754
APPLICATION OF FUNDS					
Net Block	3,156	3,129	3,017	3,124	3,065
Capital Work in Progress	55	24	92	92	92
Goodwill & Other Int. Assets	4,770	3,639	4,666	4,666	4,666
Investments	675	796	1,032	1,032	1,032
Deferred Tax Asset (Net)	65	187	101	101	101
LT Loans & Advances, Others	1,367	1,648	1,743	1,743	1,743
Total Non Current Assets	10,089	9,423	10,651	10,758	10,699
Inventories	606	979	935	1,071	1,218
Debtors and Unbilled Revenue	6,803	7,807	8,158	8,786	9,747
Cash & Bank	6,229	6,951	8,781	10,649	13,251
Liquid Investments	336	790	925	925	925
Other Current Assets	1,723	1,420	1,914	1,914	1,914
Total Current Assets	15,696	17,947	20,713	23,346	27,055
Total Application Of Funds	25,786	27,370	31,364	34,104	37,754

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Cash Flow Statement

Y/E March (Rs mn)	FY15	FY16	FY17	FY18E	FY19E
PAT	3,532	3,255	3,438	3,982	4,839
Non-operating & EO items	150	126	123	128	133
Depreciation	713	888	953	1,066	1,171
Working Capital Change	(171)	(811)	982	(320)	(274)
Cash Flow from Operations (a)	4,224	3,458	5,495	4,856	5,870
Capex	(803)	(1,282)	(909)	(1,173)	(1,112)
Investments	64	(454)	(371)	0	0
Cash Flow from Investing (b)	(739)	(1,736)	(1,280)	(1,173)	(1,112)
Debt Issuance/(Repaid)	1,415	669	(491)	0	0
Share capital Issuance	66	21	1	0	0
Dividend	(670)	(1,344)	(1,417)	(1,687)	(2,024)
Cash Flow from Financing (c)	812	(655)	(1,908)	(1,687)	(2,024)
NET CASH FLOW (a+b+c)	4,297	1,067	2,308	1,996	2,734
EO items, others	(4,981)	(344)	(478)	(128)	(133)
Closing Cash Balance	6,229	6,951	8,781	10,649	13,251
Free Cash Flow	3,421	2,176	4,586	3,683	4,758

Key Ratios

Y/E March	FY15	FY16	FY17	FY18E	FY19E
Profitability (%)					
EBITDA Margin	14.7	13.3	13.2	14.2	15.0
APAT Margin	12.9	10.5	9.5	10.2	10.9
RoE	20.6	17.3	17.1	17.8	19.5
RoIC or Core RoCE	19.7	14.9	22.3	24.5	28.5
RoCE	13.9	11.9	13.1	13.6	15.1
Efficiency					
Tax Rate (%)	24.6	24.7	24.2	27.3	27.4
Fixed Asset Turnover (x)	4.1	4.4	4.6	4.3	4.4
Inventory (days)	8	12	9	10	10
Debtors (days)	91	92	83	82	80
Payables (days)	43	42	47	48	50
Cash Conversion Cycle (days)	56	61	45	44	40
Net Debt/EBITDA (x)	(1.3)	(1.4)	(1.7)	(1.8)	(1.9)
Net Debt/Equity (x)	(0.3)	(0.3)	(0.4)	(0.4)	(0.5)
Interest Coverage (x)	57.3	19.8	22.2	27.2	35.2
Per Share Data (Rs)					
EPS	31.4	28.9	30.5	35.4	43.0
CEPS	37.8	36.8	39.0	44.9	53.5
DPS	6.0	12.0	10.5	12.5	15.0
BV	163.8	169.6	188.0	208.4	233.4
Valuation					
P/E (x)	16.4	17.8	16.9	14.6	12.0
P/BV (x)	3.1	3.0	2.7	2.5	2.2
EV/EBITDA (x)	13.2	12.7	10.5	8.7	6.8
OCF/EV (%)	8.0	6.6	11.0	10.1	12.9
FCF/EV (%)	6.5	4.1	9.2	7.7	10.5
FCFE/mkt cap (%)	7.3	6.0	9.5	8.4	10.1
Dividend Yield (%)	1.2	2.3	2.0	2.4	2.9

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Rating Guides

Rating	Expected absolute returns (%) over 12 months
BUY	>10%
HOLD	-5% to 10%
REDUCE	>-5%

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